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TORONTO, October 24, 1979 -- The proposed elimination of the compulsory retirement age is difficult to justify on economic grounds according to a report released today by the Ontario Economic Council.

"In fact banning compulsory retirement would lead to both the creation of costly new productivity measurements and a new arrangement of work rules, as well as the elimination of an effective dismissal procedure," says Dr. J.E. Pesando, University of Toronto Professor and author of the 24 page paper.

The Elimination of Mandatory Retirement: An Economic Perspective, examines the economic issues surrounding the debate over delayed retirement including the demand for work among the elderly, the effects of mandatory retirement on both pension entitlements and the tax burden borne by future workers and the need for contractual indexing of pensions to offset the effects of inflation. "Confusion still seems to exist," Pesando says, "first between the arguments based on human rights and those based on economics and, secondly, on the economic arguments themselves."

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In his analysis of the available data concerning the demand for work among the elderly, Pesando concludes that "no one has as yet proven the existence (or the absence) of a significant demand for work by those affected by mandatory retirement provisions. The continuing trend towards early retirement, together with the continuing increase in the pension entitlement of labour force participants, does suggest that caution should be exercised in entertaining claims that mandatory retirement is the most significant factor thwarting the work objectives of large numbers of elderly Canadians."

According to Pesando, proposals to eliminate mandatory retirement would require an appropriate actuarial adjustment to the pension entitlements of workers who opt for later retirement. Otherwise, the net worth of an employee's pension, if he continues to work, would decline. "If no adjustments are made to existing pension procedures," he says, "employees would have little incentive to continue working."

Pesando adds that "the argument that allowing postponed retirement will reduce the tax burden on future generations holds only if an earnings test or its equivalent were imposed on OAS and CPP benefits, a counterproductive measure."

Pesando urges the contractual indexing of pensions as a means of offsetting the effects of inflation on the incomes of the elderly. "In view of the uncertainty about the real value of their pensions during inflationary periods," he says, "workers might choose to extend their work lives if able to do so. Obviously it would be better to guarantee the worker that the real value of his pension will be preserved and enable him to decide on retirement without concern about the future rate of inflation."

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Arguments that the Canadian economy cannot afford the indexing of pensions, such as the one advanced by the Canadian Pension Conference, are "fallacious", Pesando says.

"If the pensions of retirees are fully indexed to inflation, their claim on real output of the economy is simply maintained, not increased. Only if real GNP declined would the relative share of output to pensioners increase, but even then their absolute claim on real output would remain unchanged."

"If pensions are not indexed," he continues, "inflation redistributes income away from pensioners to other economic agents. As the claim to real goods and services by pensioners is reduced by inflation, the claim by other members of society is necessarily increased."

Pesando concludes that while the present institutional setting makes it difficult for pension plan sponsors to index pensions, indexing is an economically viable objective.

Finally, Pesando says that, given the demand augmenting aspects of increased entry into the labour force, "the argument that ending compulsory retirement would reduce the job opportunities in the labour force is not substantiated by economic analysis and should be accorded the central role in the debate that it now enjoys."

The paper was prepared under the auspices of the Ontario Economic Council, established in 1962 as an independent public policy institute. The Council undertakes research and policy studies to encourage the optimum development of the human and material resources of Ontario and to support the advancement of all the sectors of the Province. The Council achieves these goals by sponsorship of research projects, publication of studies, and organization of the Outlook and Issues conferences and seminars which are open to the public.

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<u>NOTE</u>: A list of persons to contact for further information, a brief biographical sketch of the author and a selection of quotations from the paper are attached.

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FOR FURTHER INFORMATION CONTACT:

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AUTHOR'S BIOGRAPHICAL SKETCH:

James E. Pesando is Professor of Economics, Department of Political Economy, and Research Associate with the Institute for Policy Analysis at the University of Toronto. He was educated at Harvard University, University of California (Berkeley) and the University of Toronto where he received his Ph.D. in Economics.

Dr. Pesando is co-author with Samuel A. Rea, Jr. of Public and Private Pensions in Canada and has served as a consultant on pensions to the Economic Council of Canada, the Department of Finance and several private firms.

The Elimination of Mandatory Retirement: An Economic Perspective, (24 pages) is available only at the Ontario Government Bookstore, 880 Bay Street, Toronto, Ontario M7A 1N8. Price: $1:00. A cheque, or money order, payable to the Treasurer of Ontario must accompany all mail orders.

OTHER RESEARCH REPORTS prepared for the Ontario Economic Council can be obtained from the University of Toronto Press, 5201 Dufferin Street, Downsview, Ontario M3H 5T8; at major booksellers; or, from the Ontario Government Bookstore at the address above.

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SELECTED QUOTATIONS

"The argument is often made by human rights proponents that the prohibition of work by potentially productive employees after an arbitrary age shows the economic inefficiency of compulsory retirement. But in reality mandatory retirement acts as a dismissal procedure in the workplace and as such it is an integral part of the total package of work rules (pay scales, seniority provisions, and so forth) which have evolved in response to market forces. Having arisen from the interplay of market forces, compulsory retirement is difficult to challenge on efficiency grounds. Further, under present arrangements employers often have the option of retaining the services of productive employees who are beyond the retirement age, whether on a contractual or a part-time basis. In view of this option compulsory retirement is an economically efficient solution which allows employers to retain only the most productive workers. While mandatory retirement does force a worker to leave a particular job, it does not force him to retire from the active labour force." (Pg. 3)

"Unfortunately, hard evidence on worker demand for delayed retirement is difficult to obtain. Union positions in contract negotiations suggest that there is little demand by blue collar workers. In white collar and professional occupations, the absence of a move toward the postponement or elimination of mandatory retirement from within the private sector suggests there is reason to doubt that large numbers of qualified employees are being denied the opportunity to continue work.
Instead, the present trend in both Canada and the United States is towards earlier retirement. Although data on the labour force participation rates of the elderly do not provide hard facts on actual retirement decisions, they do ... indicate a steady decline in the participation rates for males in each of the three age categories (55-64, 65-9, and 70 and over). For females on the other hand there has been a rise in the participation rate for those aged 55-64 but a decline in the other two age groups. (Pgs. 4-5)

"Suppose, for example, that an employee at age 65 were entitled on the basis of his defined benefit formula to a pension of $10,000 a year. (The employee may be assumed, for instance, to have accrued benefits equal to 2 per cent of his final salary of $20,000 for each of his twenty-five years of service.) At a market interest rate of 8 per cent, and assuming the employee will have a life expectancy of fifteen years after retiring, the cost to the plan sponsor - and thus the worth to the employee - of the requisite annuity would be $85,594.

If the employee delayed retirement to age 70 and received an unadjusted pension for his then-assumed life expectancy of ten years, the cost to the plan sponsor of the requisite annuity would fall to $67,100. The present value of this amount in the year in which the employee reached 65, the appropriate comparison to the cost to the plan sponsor if the employee quits at normal retirement age, is only $45,669. Since the reduced cost to the plan sponsor means a corresponding reduction in the value of the pension to the employee, the loss of $39,925 in the net worth of his pension if he continues to work is clearly a strong incentive for him to retire at age 65.

Under the second option the employee would receive at age 70 a pension with a present value of $125,763 (i.e. $85,594 with interest accumulated for five years at 8 per cent). For the assumed life expectancy of ten years at age 70, this amount would purchase at an 8 per cent interest rate an annual pension of $18,743. Note that under the second option the cost of the pension to the plan sponsor would be the same as when the employee retires at age 65, or $85,594 at the time the employee reaches this age." (Pgs. 9-10)

"How would the elimination of mandatory retirement reduce the tax burden on future generations of workers arising from the projected increase in the pensioner ratio and the essentially paygo nature of OAS and the CPP? If (1) the age of entitlement of OAS were raised, at least for those who continued to work past 65, (2) benefits payable under the CPP were postponed without actuarial adjustment to the actual date of retirement, as in the first option analysed for employer-sponsored plans, or (3) a means test were introduced for OAS and/or CPP benefits, then such a reduction in the tax burden might occur. Each of these options, however,

is clearly independent of the question whether or not to ban compulsory retirement. Further, each would serve - in effect - as a tax on the earnings of those who chose to work beyond the normal retirement age of 65, and as such would serve as a strong disincentive to such individuals to remain in the labour force. If the purpose of a ban on mandatory retirement is to encourage work by those beyond normal retirement age, each of the three options would be clearly counterproductive." (Pgs. 13-14)

"There is no reason to believe that a long-term increase in the rate of inflation will lead to a reduction in the real rate of growth of GNP, let alone in its level. The problem posed by inflation instead concerns its arbitrary impact on the distribution of income or upon the claims to real GNP. If real GNP is unaffected by inflation, then for each net loser from inflation there is a net gainer, and conversely. If pensions are not indexed, inflation redistributes income away from pensioners to other economic agents. As the claim to real goods and services by pensioners is reduced by inflation, the claim by other members of society is necessarily increased. A legitimate concern of plan sponsors in the private sector is that recent inflation has redistributed income away from them. Issuers of fixed-income securities and possibly the government, but not pensioners, have benefited from this income transfer. In short, plan sponsors cannot easily index benefits under the present institutional setting." (Pg. 18)

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There is [illegible] inflation [illegible] institutional setting." (Pg. 18)